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Fire Insurance Recovery Rights of the Foreclosing Mortgagee: Is His Lien Lost in the Ashes?

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NOTES

FIRE INSURANCE RECOVERY RIGHTS OF THE FORECLOSING MORTGAGEE: IS HIS LIEN LOST IN THE ASHES?

I. Introduction

A mortgagee's security is affected by changes in the market value of the mortgaged premises.[1] Fire damage,[2] which diminishes its value, may erode the mortgagee's ability to safeguard his investment because the premises often must be sold for less than the outstanding debt should the mortgagee be forced to foreclose on his lien. Consequently, fire insurance policies invariably contain a "standard mortgage clause" separately insuring the mortgagee "as his interest may appear."[3] The standard mortgage clause further provides that the insurable interest of the mortgagee "shall not be invalidated by act of foreclosure."[4] However, where loss precedes a foreclosure action or occurs during the pendency thereof, the mortgagee may not be fully indemnified.

This Note will explore the question of the mortgagee's insurable interest under the standard mortgage clause as the process of foreclosure ripens his status from that of mortgagee to that of property owner. It will further examine how such changes in status can extinguish the mortgagee's interest and will discuss the principal arguments raised against the prevailing rules.

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1. For centuries, the personal responsibility and financial strength of a prospective mortgagor was the determining factor in a mortgagee's decision whether to extend credit to the mortgagor. With the development of modern real estate financing, however, the mortgagor's personal financial status has become less important; mortgagees now seek the collateral of real property as security for a loan. C. WILTSIE, REAL PROPERTY MORTGAGE FORECLOSURE § 1 (5th ed. 1939) [hereinafter cited as WILTSIE].

2. While the standard mortgage clause discussed herein is only mandatory in policies of fire insurance, contracting parties are of course free to extend the protection it provides to other types of homeowner's losses. N.Y. INS. LAW § 168(5), lines 25-41 (McKinney Supp. 1979).

3. *See* note 19 *infra*.

4. *Id.*

II. Background

A. The Standard Fire Insurance Policy

Prior to the end of the nineteenth century, each insurer drew up a unique contract to be used by that company for insuring property against loss by fire. Insurers often made these contracts complicated to confuse insureds and to keep them ignorant of their rights under the policy.[5] Policies were frequently revised to mitigate the effect of judicial decisions adverse to the insurer[6] and eventually became so unnecessarily complex that the attorneys who drafted the policies had difficulty ascertaining what losses were covered.[7]

The complexity and widespread variation among policies made claims adjustment so difficult that even the insurance companies favored the development of a uniform contract.[8] A standard policy form was first enacted in Connecticut in 1867, but was repealed the following year.[9] The first standard policy in which terms were rigidly prescribed by statute was adopted by the Commonwealth of Massachusetts in 1873, but its use was optional.[10] Michigan and New Hampshire, in 1881 and 1885 respectively, passed statutes authorizing the preparation of standard policies.[11] In 1886, the New York Board of Fire Underwriters[12] proposed a standard policy

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5. E. VAUGHAN & C. ELLIOTT, FUNDAMENTALS OF RISK AND INSURANCE 355 (2d ed. 1978) [hereinafter cited as VAUGHAN & ELLIOTT]. "As if it were feared that someone would, in spite of [the incomprehensible language] discover the meaning of the contract, the policy was printed in extremely small type and long, crowded lines, so that 'the perusal of it was made physically difficult, painful and injurious.'. . . The size of print in fire policies is now prescribed by law nearly everywhere." R. RIEGEL, J. MILLER & A. WILLIAMS, JR., INSURANCE PRINCIPLES AND PRACTICES 144 (6th ed. 1976) [hereinafter cited as RIEGEL, MILLER & WILLIAMS].

6. Some companies attemped to devise policies which would impose as little liability upon themselves as possible. RIEGEL, MILLER & WILLIAMS, *supra* note 5, at 144.

7. VAUGHAN & ELLIOTT, *supra* note 5, at 355.

8. *Id.*

9. W. VANCE, LAW OF INSURANCE 57 n.5 (3d ed. 1951) [hereinafter cited as VANCE.]

10. *Id.* at 57.

11. *Id.* The Michigan statute was declared unconstitutional in 1905 on the ground that allowing the Commissioner of Insurance to fix such rules was an improper delegation of a legislative power. King v. Concordia Fire Ins. Co., 140 Mich. 258, 103 N.W. 616 (1905). Similar statutes in Minnesota, Pennsylvania, Wisconsin and Missouri were invalidated on the same ground. Other states avoided constitutional challenges by having the legislature adopt Commissioner-proposed rules. VANCE, *supra* note 9, at 59.

12. The Board was assisted by the National Board of Fire Underwriters, the State Superintendent of Insurance, and distinguished members of the New York insurance bar. VANCE, *supra* note 9, at 58.

which was adopted in 1887 as the only form permissible in the State of New York.[13] The "New York Standard Fire Policy" gradually gained widespread acceptance throughout the United States. It was revised in 1918 and again in 1943,[14] and continues to be used in most jurisdictions. Twelve states use forms with insignificant variations from the New York Standard Policy[15] and four have different forms.[16]

There are several advantages to a standard fire policy. Every insurer issues the same basic contract of insurance, tailored by minor variations to fit the needs of each case. Judicial decisions gradually define the terms contained in the policy and the public gains familiarity with these terms. Discrepencies between different policies are decreased, claims adjustment is facilitated, and the volume of litigation is reduced.[17]

B. The Standard Mortgage Clause

A mortgagee generally requires a mortgagor to procure a fire policy as a condition for financing the purchase. As explained,[18] this policy is standard. Virtually all fire insurance policies contain a "standard mortgage clause"[19] which protects the interest of the

13. N.Y. INS. LAW § 168 (McKinney 1966).

14. RIEGEL, MILLER & WILLIAMS, *supra* note 5, at 144; VAUGHAN & ELLIOTT, *supra* note 5, at 355. The policy was also known as the "New York Standard Form." *Id.*

15. California, Florida, Georgia, Hawaii, Indiana, Kansas, Maine, Missouri, New Mexico, North Dakota, South Carolina and Vermont. *See generally* Comment, *Arson Fraud: Criminal Prosecution and Insurance Law*, 7 FORDHAM URB. L.J. 541, 570 (1979).

16. Massachusetts, Minnesota, Texas, and Wisconsin.

17. RIEGEL, MILLER & WILLIAMS, *supra* note 5, at 144.

18. *See* notes 12-16 *supra* and accompanying text.

19. The standard mortgage clause is sometimes referred to as the "New York Standard" or the "union mortgage clause." An example of such a clause, in common use, is as follows:

> Loss, if any, under this policy shall be payable to the aforesaid as mortgagee (or trustee) *as interest may appear* under all present or future mortgages upon the property herein described in which the aforesaid may have an interest as mortgagee (or trustee), in order of precedence of said mortgages, and this insurance, as to the interest of the mortgagee (or trustee) only therein, *shall not be invalidated by any act or neglect of the mortgagor* or owner of the within described property, *nor by any foreclosure* or other proceedings or notice of sale relating to the property, nor by any change in the title or ownership of the property, nor by the occupation of the premises for purposes more hazardous than are permitted by this policy; provided that in case the mortgagor or owner shall neglect to pay any premium due under this policy, the mortgagee (or trustee) shall, on demand, pay the same.
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> Provided, also that the mortgagee (or trustee) shall notify this Company of any change of ownership or occupancy or increase of hazard which shall come to the

mortgaged premises. The policy insures the mortgagee "as his interest may appear"[20] despite any act or neglect which would violate the terms of the policy on the part of the mortgagor.[21] This clause effectively gives the mortgagee a "separate contract of insurance" with the mortgagor's insurance carrier,[22] thereby allowing the mortgagee to bring suit on the policy in his own name.[23] In addition, a standard mortgage clause protects the interest of the mortgagee

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knowledge of said mortgagee (or trustee) and, unless permitted by this policy, it shall be noted thereon and the mortgagee (or trustee) shall, on demand, pay the premium for such increased hazard for the term of the use thereof; otherwise this policy shall be null and void.

This Company reserves the right to cancel this policy at any time as provided by its terms, but in such case this policy shall continue in force for the benefit only of the mortgagee (or trustee) for ten days after notice to the mortgagee (or trustee) of such cancellation and shall then cease, and this Company shall have the right, on like notice to cancel this agreement.

Whenever this Company shall pay the mortgagee (or trustee) any sum for loss under this policy and shall claim that, as to the mortgagor or owner, no liability therefor existed, this Company shall, to the extent of such payment, be thereupon legally subrogated to all the rights of the party to whom such payment shall be made, under all securities held as collateral to the mortgage debt, or may, at its option, pay to the mortgagee (or trustee) the whole principal due or to grow due on the mortgage with interest, and shall thereupon receive a full assignment and transfer of the mortgage and of all such other securities; but no subrogation shall impair the right of the mortgagee (or trustee) to recover the full amount of said mortgagee's (or trustee's) claim.

Connally, *Mortgagor-Mortgagee Problems and the Standard Mortgage Clause*, 13 FORUM 786, 787-88 n.4 (1978) (emphasis supplied).

20. 6A APPLEMAN, INSURANCE LAW AND PRACTICE § 4164 at 477 n.43 (1970) [hereinafter cited as APPLEMAN]; 11 COUCH ON INSURANCE § 42:648 (2d ed. 1960) [hereinafter cited as COUCH].

21. The standard mortgage clause applies to acts or omissions of the mortgagor previous or subsequent to the formation of the contract. Stockton v. Atlantic Fire Ins. Co., 207 N.C. 43, 175 S.E. 695 (1934). 11 COUCH, *supra* note 20, §§ 42:658, :687. VANCE, *supra* note 9, at 776.

22. Hartford Fire Ins. Co. v. Associates Capital Corp., 313 So. 2d 404, 407 (Miss. Sup. Ct. 1975); General Elec. Credit Corp. v. Aetna Cas. & Sur. Co., 437 Pa. 463, 263 A.2d 448 (1970); General Motors Acceptance Corp. v. Western Fire Ins. Co., 457 S.W.2d 234, 236 (Mo. App. 1970). This is, of course, subject to the qualification that no separate contract arises if the mortgagee rejects the policy. Continental Ins. Co. v. Ferro, 109 N.J. Eq. 374, 157 A. 558 (1931). However, this "separate contract" is not a complete contract in itself. 11 COUCH *supra* note 20, § 42:650. The mortgagee may be viewed more as a third party creditor-beneficiary rather than as a separate party to the contract of insurance. Walker v. Queen Ins. Co., 136 S.C. 144, 134 S.E. 263 (1926).

23. RIEGEL, MILLER & WILLIAMS, *supra* note 5, at 52-53. Where the mortgagor obligated himself to insure the mortgagee but did not, equity will treat the policy as having contained a mortgage clause and thus entitle mortgagee to bring suit thereunder. Andrello v. Nationwide Mut. Fire Ins. Co., 29 A.D.2d 489, 289 N.Y.S.2d 293 (4th Dep't 1968).

even if the policy was itself void as to the mortgagor *ab initio*,[24] and even if the mortgage suffered no actual loss.[25] The clause is enforceable whether or not physically attached to the policy,[26] and whether or not the mortgagee was aware of its existence.[27]

This separate contract grants the mortgagee several advantages. Foremost among these is the reasonable certainty that his loan will be repaid by someone. Should the mortgagor default on his payments and the mortgagee is unable to satisfy a judgment of foreclosure by sale because destruction has diminished the value of the premises, the mortgagee may, in theory,[28] use the insurance proceeds to satisfy the mortgage obligation.[29] In addition, the mortgagee preserves his interest unimpaired by the subrogation rights of the insurer.[30] Finally, the mortgagee is entitled to ten days notice of cancellation of the policy by the carrier, instead of the five days notice which must be given to the mortgagor.[31] In return for the extensive protection provided by the standard mortgage clause, the mortgagee assumes relatively little responsibility. He is obligated only to pay the premium if it is not paid by the mortgagor[32] and to notify the insurer of any change in ownership or increase in hazard within his knowledge.[33]

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24. Oklahoma State Union of Farmers' Educ. & Coop. Union v. Folsom, 325 P.2d 1053 (Okla. Sup. Ct. 1958); Great Am. Ins. Co. v. Southwestern Fin. Co., 297 P.2d 403 (Okla. Sup. Ct. 1956); 11 COUCH, *supra* note 20, § 42:695.

25. Savarese v. Ohio Farmers Ins. Co., 260 N.Y. 45, 182 N.E. 665 (1932). The mortgagee will suffer no actual loss when premises have been restored in value or even increased beyond what they were worth prior to a fire. Nevertheless, mortgagee may not lose his right to recover insurance proceeds. *Id. But see* N.Y. REAL PROP. LAW § 254(4) (McKinney Supp. 1979).

26. Fidelity-Phenix Fire Ins. Co. v. Cleveland, 57 Okla. 237, 244, 156 P. 638, 640 (1916); *cf.* Tarleton v. DeVeuve, 113 F.2d 290, 297 (9th Cir. 1940), *cert. denied*, 312 U.S. 691 (1941).

27. 113 F.2d at 297.

28. As noted herein, the mortgagee does not always recover his loss. *See* notes 66-75 *infra* and accompanying text.

29. *But see* notes 66-75 *infra* and accompanying text.

30. RIEGEL, MILLER & WILLIAMS, *supra* note 5, at 53.

31. Aetna State Bank v. Maryland Cas. Co., 345 F. Supp. 903 (N.D. Ill. 1972); RIEGEL, MILLER & WILLIAMS, *supra* note 5, at 53.

32. In the event the mortgagee fails to pay a premium not paid by the mortgagor, the policy lapses and neither party has his interest protected. Courts are divided on whether the clause imposes a contractual duty on the mortgagee to pay premiums or merely gives the mortgagee an option to keep the insurance in force. VANCE, *supra* note 9, at 776.

33. RIEGEL, MILLER & WILLIAMS, *supra* note 5, at 52; Lev, *Mortgagees and Insurers: The Legal Nuts and Bolts of Their Relationship*, 12 FORUM 1012, 1014 (1977). However, if the consequences of a mortgagee's failure to give such notice to insurer are not specified in the

Mortgagees have received this advantageous treatment because they have a recognized right to protection[34] and are generally unable to control the acts of the mortgagor.[35] Moreover, insurers view mortgagees as desirable customers because mortgagees provide them with a large volume of business[36] and share with the insurer an interest in maintaining the value of the insured premises.[37]

The standard mortgage clause must be distinguished from the older and now little-used loss payable clause,[38] wherein the mortgagee is not protected by a separate contract of insurance.[39] Under that clause, the mortgagee can recover only to the extent that the mortgagor would be entitled to collect on the policy. This derivative interest of the mortgagee will be invalidated upon any act or neglect on the part of the mortgagor.[40] The mortgagee is viewed only as an appointee to receive said insurance funds[41] as no greater or different burden is assumed by the insurer; the clause merely designates to whom the loss will be paid.[42] A second critical distinc-

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policy, the mortgagee may still be protected absent notice. *See* Kentucky Farm Bureau Mut. Ins. Co. v. Conley, 498 S.W.2d 122, 127 (Ky. Ct. App. 1973).

34. 5A APPLEMAN, *supra* note 20, § 3381; 11 COUCH, *supra* note 20, § 42:683.

35. RIEGEL, MILLER & WILLIAMS, *supra* note 5, at 53.

36. The mortgagee often procures the insurance for the mortgagor and, consequently, can direct the flow of his business as he chooses.

37. Mortgagees are usually large lending institutions or responsible individuals likely to keep the insurance in force and to guard against destruction of their security interests, although they are under no duty to do so. 11 COUCH, *supra* note 20, § 42:653.

38. The loss payable clause is also referred to as the "simple loss payable" or "open mortgage clause." 11 COUCH, *supra* note 20, § 42:648.

39. Jurists writing opinions on mortgage clause cases frequently use the terms "standard mortgage clause" and "loss payable clause" interchangeably. This leads to unnecessary confusion among courts and law review writers. *See, e.g.*, Note, *Foreclosure, Loss, and the Proper Distribution of Insurance Proceeds Under Open and Standard Mortgage Clauses: Some Observations*, 7 VAL. L. REV. 485, 489 (1973) [hereinafter cited as *Observations*]. Although admittedly an over-simplification, the two clauses have been distinguished on the basis that the loss payable clause is subject to such defenses as the insurer may have against the mortgagor while the standard clause is not subject to such defenses. COUCH, *supra* note 20, § 42:649. In addition, a loss payable clause may not contain the term "as interest may appear." *Id.* In case of doubt, the clause should be construed to be a standard clause. *Id.* § 42:684.

40. 5A APPLEMAN, *supra* note 20, § 3401; 11 COUCH, *supra* note 20, §§ 42:660,:671; VANCE, *supra* note 9, at 775.

41. Kimberly & Carpenter v. National Liberty Ins. Co., 35 Del. 63, 67, 157 A. 730, 732 (1931); Southern States Fire & Cas. Ins. Co. v. Napier, 22 Ga. App. 361, 96 S.E. 15 (1918); 11 COUCH, *supra* note 20, § 42:660. *Contra*, Walker v. Queen Ins. Co., 136 S.C. 144, 134 S.E. 263 (1926).

42. Capital Fire Ins. Co. v. Langhorne, 146 F.2d 237, 241 (8th Cir. 1945); German Ins. Co. v. Hayden, 21 Colo. 127, 40 P. 453 (1895); Wharen v. Markle Banking & Trust Co., 145

tion between standard and loss payable clauses is that, under the latter, the timing of foreclosure with respect to loss does not affect a mortgagee's recovery. Whether loss follows foreclosure, or foreclosure follows loss, once the mortgage debt is fully extinguished the mortgagee's rights under the insurance contract are terminated.[43] This is not the rule with respect to the standard mortgage clause.

III. Recovery Rights of a Foreclosing Mortgagee

The mortgagee's right to foreclose[44] on his security accrues upon default by the mortgagor on one of the mortgage terms.[45] An action in foreclosure is commenced by serving a copy of the summons and complaint on all necessary parties.[46] The mortgagee will then procure a judgment of foreclosure directing that the mortgaged premises be sold under the direction of the county sheriff or a referee.[47] The judgment of foreclosure typically includes costs of bringing the action and expenses of the sale in addition to the outstanding mortgage debt plus interest.[48] Sale is then held at public auction in the county in which the mortgaged premises are situated.[49] It is a common practice for the mortgagee to bid in the amount of his judgment, presuming the premises are worth at least that much, at the foreclosure sale. If the mortgagee is the highest bidder, he simply "buys back" the premises[50] and becomes the owner, thereby extinguishing the mortgage debt.[51] If another puchaser outbids the

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Pa. Super. 99, 102, 20 A.2d 885, 887 (1941).

43. Reynolds v. London & Lancashire Fire Ins. Co., 128 Cal. 16, 60 P. 467, 468 (1900); *Observations, supra* note 39, at 489.

44. Foreclosure has been defined as "a procedure whereby at a definite time the title to the mortgaged premises is transferred absolutely from the mortgagor and his subsequent lienors to a purchaser . . . ." WILTSIE, *supra* note 1, § 2.

45. WILTSIE, *supra* note 1, § 39. In the absence of an acceleration clause, the right to foreclose generally does not vest until the law day of the debt secured by the mortgage. *Id.* However, virtually all mortgage instruments contain an acceleration clause.

46. Note, *The Mortgagee and the Federal Government,* 31 BROOKLYN L. REV. 120, 121 (1964). In New York, the procedure is governed by articles 13 and 14 of the Real Property Actions and Proceedings Law.

47. N.Y. REAL PROP. ACTS § 1351 (McKinney 1979). New York also provides for foreclosure by advertisement, wherein notice of sale is made by publication. *Id.* §§ 1401-1402.

48. *Id.* §§ 1351, 1431, 1432.

49. *Id.* § 1407.

50. When the mortgagee purchases his security at a foreclosure sale, cash is not exchanged. His payment is merely reflected by a bookkeeping transaction.

51. The mortgagee will usually thereafter sell the property to recover his investment.

mortgagee, the sale proceeds are first used to satisfy the judgment of foreclosure. The mortgagor is then entitled to the surplus of the sale price over the judgment[52] and the highest bidder thereafter becomes owner in fee.[53] If the highest bid at sale, whether made by the mortgagee or a third person, is less than the judgment of foreclosure, the mortgagee may assert a deficiency judgment for the difference against the mortgagor.[54]

A complex set of rules has been developed to determine the amount of the mortgagee's recovery under the standard mortgage clause when a loss occurs. The mortgagee's recovery is limited to his interest "as it may appear."[55] This interest will depend on the timing of the foreclosure action in relation to the loss and the extent to which the mortgagee has had his debt satisfied.

A. Where Foreclosure Sale Precedes Loss

Insurance companies attempted to escape liability to standard fire policy mortgagees who have "bought in" their interest at foreclosure and subsequently suffered loss or destruction to the subject premises by maintaining that the term "as interest may appear" in the standard mortgage clause protects only the interest held at the time the policy was issued.[56] A mortgagee, it was argued, was insured only in his capacity as mortgagee and not as owner.[57] Mortgagees maintained that the term in the standard mortgage clause which states that "the interest of the mortgagee shall not be invalidated by act of foreclosure"[58] protects their interest where foreclosure precedes the loss. Courts have consistently upheld the mortgagee's position.[59]

In *Shores v. Rabon*,[60] for example, the Supreme Court of North

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52. The surplus is termed "equity" and actually paid into the supreme court, N.Y. REAL PROP. ACTS. § 1441 (McKinney 1979), and a petition must be brought by the mortgagor to recover his equity. *Id.* § 1442.

53. Title passes only after the officer conducting the sale executes a deed to the purchaser. *Id.* § 1353.

54. *Id.* § 1371.

55. *See* note 19 *supra*.

56. *E.g.*, Guardian Sav. & Loan Ass'n v. Reserve Ins. Co., 2 Ill. App. 3d 77, 78, 276 N.E.2d 109, 110 (1971).

57. *Id.* at 79, 276 N.E.2d at 111.

58. *See* note 19 *supra*.

59. *See, e.g.*, Nationwide Mut. Fire Ins. Co. v. Wilborn, 291 Ala. 193, 197, 279 So. 2d 460, 462-63 (1973); Haskin v. Greene, 205 Or. 140, 149, 286 P.2d 128, 133 (1955); City of Chicago v. Maynur, 28 Ill. App. 3d 751, 755, 329 N.E.2d 312, 315 (1975).

60. 251 N.C. 790, 112 S.E.2d 556 (1960).

Carolina rejected the argument that foreclosure extinguished a mortgagee's interest under the policy. The *Shores* court viewed acquisition of title as an increase in interest rather than as a change in ownership.[61] Similarly, in *Union Central Life Insurance Co. v. Codington County Farmers Fire & Lightning Mutual Insurance Co.*,[62] the Supreme Court of South Dakota emphatically rejected the argument that the word "mortgagee" as used in the standard clause refers only to one who remains in that capacity. The court stated that "if it had been intended that the protection of the mortgagee should cease with the foreclosure of the mortgage . . . that intention would have been expressed in unequivocal words."[63] Thus, where foreclosure precedes loss, the separate contract of insurance arising under the standard mortgage clause will fully protect[64] the mortgagee against loss occurring subsequent to the foreclosure on his lien.

B. Where Foreclosure Sale Follows Loss

In most jurisdictions, the mortgagee who commences foreclosure proceedings after the mortgaged premises are damaged or destroyed will lose his insurable interest to the extent that the judgment is satisfied by purchase at sale.[65] The New York Court of Ap-

61. *Id.* at 795, 112 S.E.2d at 560. By refusing to hold that ownership of the premises had transferred to the mortgagee, the court, in effect, absolved the mortgagee from penalty for failure to notify the carrier of change in ownership, as required by the policy. *Id.* at 796, 112 S.E.2d at 561.

62. 66 S.D. 561, 287 N.W. 46 (1939).

63. *Id.* at 565, 287 N.W. at 50.

64. The mortgagee is protected to the extent of his insurable interest, a fundamental tenet of insurance law. American Ice Co. v. Eastern Trust & Banking Co., 188 U.S. 626, 629 (1903). *See also* Hagan v. Scottish Ins. Co., 186 U.S. 423, 433 (1902); Sturm v. Boker, 150 U.S. 312, 333 (1893). Generally, the rule applied to property insurance is that an insurable interest vests in one who derives benefit from the property or who would suffer loss from its destruction; title, a security or a possessory interest is irrelevant. Harrison v. Fortlage, 161 U.S. 57, 65 (1896); Hooper v. Robinson, 98 U.S. 528, 537 (1879); Lumbermens Mut. Ins. Co. v. Edmister, 412 F.2d 351, 353 (8th Cir. 1969). Thus, the mortgagee is insured "as his interest may appear." The rationale for predicating rights under the policy on interest in the property insured is that one who stands to recover financially should suffer concomitant loss, lest he fraudulently cause the policy to become payable. *See* Pinzur, *Insurable Interest: A Search for Consistency*, 46 INS. COUNSEL J. 109 (1979). Some commentators have advocated that insurers who accept premiums when they know or should know that an insurable interest is lacking should be estopped from raising the defense of lack of insurable interest. *See, e.g.*, Note, *Insurance: Insurable Interest in Oklahoma—Time for a Change*, 31 OKLA. L. REV. 718 (1978).

65. Mann v. Glens Falls Ins. Co., 541 F.2d 819, 823 (9th Cir. 1976); Insurance Co. of

peals enunciated the majority rule in *Whitestone Savings & Loan Association v. Allstate Insurance Co.*[66] At a foreclosure sale one year after a fire damaged the premises, plaintiff-mortgagee bid in the full amount of the balance then owing on the mortgage.[67] Whitestone's bid was for an amount greater than the actual market value of the damaged premises. Therefore, on resale, Whitestone received less than it had "paid" for the premises.[68] The mortgagee brought an action against the insurer of the premises for payment of insurance proceeds payable due to the loss. The court, relying on *Rosenbaum v. Funcannon,*[69] held that Whitestone did not retain any insurable interest entitling it to sue on the policy. In *Rosenbaum,* the Court of Appeals for the Ninth Circuit distinguished foreclosure, which does not extinguish mortgagee's interest *per se,* from the satisfaction of the mortgage debt: "[E]xtinguishment of a mortgage or deed of trust by sale of the property at foreclosure does not necessarily extinguish the debt itself. Only to the extent that

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North America v. Citizens Ins. Co., 425 F.2d 1180, 1182 (7th Cir. 1970); Rosenbaum v. Funcannon, 308 F.2d 680, 685 (9th Cir. 1962); Lutheran Bhd. v. Hooten, 237 So. 2d 23, 24 (Fla. App. 1970); Northwestern Nat'l Ins. Co. v. Mildenberger, 359 S.W.2d 380 (Mo. App. 1962); Power Bldg. & Loan Ass'n v. Ajax Fire Ins. Co., 110 N.J.L. 256, 164 A. 410 (1933); Whitestone Sav. & Loan Ass'n v. Allstate Ins. Co., 28 N.Y.2d 332, 270 N.E.2d 694, 321 N.Y.S.2d 862 (1971); Gattavara v. General Ins. Co., 166 Wash. 691, 8 P.2d 421 (1932). *See also* APPELMAN, *supra* note 20, § 3403; 5 COUCH, *supra* note 20, §§ 29:75 to :77; 55 AM. JUR. 2D *Mortgages* §§ 274-83 (1971); 38 N.Y. JUR. *Mortgages and Deeds of Trust* § 143 (1964). Courts are unconcerned with the results of a resale, regardless of whether the mortgagee profits or suffers a loss thereby. For example, a Tennessee court held that mortgagees who foreclosed after fire loss, bought the property for $250 and later sold it for $7000, thereby making a profit considerably more than their outstanding debt did not lose their right of recovery. National Union Fire Ins. Co. v. Davis, 389 S.W.2d 941 (Tenn. Ct. App. 1965).

66. 28 N.Y.2d 332, 270 N.E.2d 694, 321 N.Y.S.2d 862 (1971). The interpretation of standard fire policy matters by the courts of New York is given great weight. *See, e.g.,* Goodman v. Quaker City Fire & Marine Ins. Co., 254 F.2d 844, 845 (1st Cir. 1958).

67. 28 N.Y.2d at 334, 270 N.E.2d at 695, 321 N.Y.S.2d at 864.

68. Interviews with members of the real estate and banking bar: John A. Burns, Jr., Esq., James G. Meade, Esq., George J. Meade, Esq., John H. Munley, Esq. and William J. Nielsen, Esq., Great Neck, New York (January 4, 1980).

69. 308 F.2d 680 (9th Cir. 1962). Some commentators, *e.g., Observations, supra* note 39, at 496, observe that the rationale in *Rosenbaum* is supported by loss payable mortgage clause cases; *e.g.,* Reynolds v. London & Lancashire Fire Ins. Co., 128 Cal. 16, 60 P. 467 (1900). If true, *Whitestone* and its progeny may be based upon a faulty premise. However, there is one major caveat: judges often use the term"loss payable" in an opinion on a standard mortgage clause case even though the two clauses are radically different. For example, the *Whitestone* court repeatedly refers to the clause in question as the "loss payable clause" despite the fact that it was clearly a standard clause. 28 N.Y.2d 332, 270 N.E.2d 694, 321 N.Y.S.2d 862 (*passim*).

the mortgagee receives payment upon the debt through the foreclosure is the debt itself extinguished."[70]

The loss/foreclosure rule is premised on the rationale that because the mortgagee is entitled to only one satisfaction of his debt, the bidding in of the debt amount to purchase the mortgaged property, which thereby cuts off lower bidders, always constitutes a satisfaction of the debt.[71] The mortgagee, it is reasoned, has the choice of either satisfying his lien by foreclosure or looking to the insurer for indemnification.[72] He is free to pursue either remedy or a combination thereof to the extent that his recovery does not exceed the judgment of foreclosure. The mortgagee's successful bid for less than the amount of the mortgage debt would leave "a deficiency for which the mortgagor would be obligated and from which there would survive an insurable interest."[73] Because the mortgagee bid in the amount of the judgment, there was no deficiency to define the extent of his insurable interest. To permit the mortgagee to recover insurance proceeds, it was argued, might result in a double recovery. Further, the result in *Whitestone* ostensibly guards against fraud by the mortgagee. The court, in *Whitestone,* was concerned that, by allowing the mortgagee effectively to cut off or discourage lower bidders by bidding in more than the value of the property and then to try to assert that the property was in fact worth less "encourages fraud [and] creates uncertainty as to the mortgagor's rights."[74] The court emphasized that the bank had voluntarily converted the mortgagors' debt into a fee interest by purchase at the sale[75] and that Whitestone had ample opportunity to tailor its bid to reflect the value of the property it was purchasing.

This rule was extended slightly in New York by *Moke Realty Corp. v. Whitestone Savings & Loan Association.*[76] Moke Realty

70. Rosenbaum v. Funcannon, 308 F.2d 680, 684 (9th Cir. 1962).

71. Whitestone Sav. & Loan Ass'n v. Allstate Ins. Co., 28 N.Y.2d at 335, 270 N.E.2d at 696, 321 N.Y.S.2d at 864.

72. Nationwide Mut. Fire Ins. Co. v. Wilborn, 291 Ala. 193, 198, 279 So. 2d 460, 463 (1973).

73. 28 N.Y.2d at 335, 270 N.E.2d at 696, 321 N.Y.S.2d at 864.

74. *Id.* at 337, 270 N.E.2d at 697, 321 N.Y.S.2d at 866. The court may have assumed that Whitestone acted in bad faith in bidding on the mortgagors' premises. However, this is unsupported by the facts. *See* notes 96-98 *infra* and accompanying text.

75. 28 N.Y.2d at 335, 270 N.E.2d at 696, 321 N.Y.S.2d at 964.

76. 82 Misc. 2d 396, 370 N.Y.S.2d 377 (Sup. Ct. 1975), *aff'd*, 51 A.D.2d 1005, 382

Corp. (Moke) owned a restaurant building which formed the security for several mortgages held by Whitestone. After the restaurant was totally destroyed by fire, Moke defaulted on its mortgage payments and Whitestone foreclosed. Whitestone obtained a judgment of foreclosure for $50,488.13 and bought the property at sale for $26,000, leaving a difference of $24,488.13 between the mortgage debt and the amount it realized on the sale.[77] Whitestone should have had little trouble in turning to Moke's insurer to satisfy its deficiency. However, the trial judge ruled that, because Whitestone had failed to enter a deficiency judgment within the ninety day time limit prescribed by section 1371 of the Real Property Actions and Proceedings Law,[78] it was estopped from attaching insurance proceeds to satisfy the deficiency.[79] The statute provides that: "If no motion for a deficiency [is] made . . . the proceeds of the sale regardless of amount shall be deemed to be in full satisfaction of the mortgage debt and no right to recover any deficiency in any action or proceeding shall exist."[80] The judge held that under *Whitestone v. Allstate* the mortgagee's insurable interest in the property was terminated and recovery on the fire policy was denied. *Moke* was unanimously affirmed by the appellate division[81] and by the court of appeals.[82]

The State of Georgia has a statute[83] similar to New York's section 1371, but unlike section 1371, it does not operate to extinguish a debt upon untimely filing; it merely limits the creditor's remedies.[84] In addition, the Georgia statute does not prevent a creditor

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N.Y.S.2d 289 (2d Dep't 1976), *aff'd*, 41 N.Y.2d 954, 363 N.E.2d 587, 394 N.Y.S.2d 881 (1977).

77. *Id.* at 397; 370 N.Y.S.2d at 379.

78. N.Y. REAL PROP. ACTS. § 1371 (McKinney 1979).

79. 82 Misc. 2d at 397-98; 370 N.Y.S.2d at 380.

80. N.Y. REAL PROP. ACTS. § 1371(3) (McKinney 1979). The statute implicitly works to the benefit of the insurer as well as the mortgagor.

81. 51 A.D.2d 1005, 382 N.Y.S.2d 289 (2d Dep't 1976).

82. 41 N.Y.2d 954, 363 N.E.2d 587, 394 N.Y.S.2d 881 (1977).

83. GA. CODE ANN. § 67-1503 (Cum. Supp. 1979) provides:

> When any real estate is sold on foreclosure . . . and at such sale said real estate does not bring the amount of the debt secured by [the] deed, mortgage, or contract, no action may be taken to obtain a deficiency judgment unless the person instituting the foreclosure proceedings shall, within 30 days after such sale, report the sale to the judge of the superior court of the county in which the land lies for confirmation and approval, and obtains an order of confirmation and approval thereon.

84. Power v. Wren, 198 Ga. 316, 322, 31 S.E.2d 713, 716 (1944); Marler v. Rockmart Bank, 146 Ga. App. 548, 549, 246 S.E.2d 731, 733 (1978); Turpin v. North Am. Acceptance

from pursuing another contractual security on the debt.[85] In *Calvert Fire Insurance Co. v. Environs Development Corp.*,[86] the Court of Appeals for the Fifth Circuit, applying Georgia law, decided whether a mortgagee who had bought back the property for the full amount of the mortgage principal plus interest then owing, but exclusive of attorney's fees allegedly due, could assert a deficiency against the insurer. As in *Moke*, the mortgagee had failed to procure, in timely fashion, a judicial confirmation and approval of the sale. The court held that the deficiency was recoverable. It reasoned that the mortgagee's "status as loss-payee gives it no less a separate contractual remedy than would an additional security deed on other property";[87] because the Georgia statute does not prohibit such a remedy, the mortgagee may look to the insurer to recover the deficiency.[88]

It might initially appear that the *Calvert* court has impaired the effectiveness Georgia's deficiency judgment statute. Proponents of the *Moke* rationale that recovery rights are lost by inaction would mandate that deficiency judgment statutes be complied with before any or all rights arising thereunder are honored. *Calvert*, however, is more consistent with the concept of independent recovery provided by the standard mortgage clause.[89] Moreover, the *Whitestone/Moke* reasoning represents an unholy marriage of contract and property law. A deficiency judgment statute[90] is applicable to the foreclosure process, which arises out of the law of real property. Conversely, an insurance policy is governed by contract law. It is an agreement by the insurer to indemnify the mortgagee on the occurrence of a loss. Arguably, it is illogical to allow nonperformance of an executory and independent contract by operation of a statute governing rights arising under the law of property. The majority of jurisdictions, however, have rejected this argument and refuse to distinguish contract law from real property law in this

Corp., 119 Ga. App. 212, 217, 166 S.E.2d 588, 592 (1969).

85. Salter v. Bank of Commerce, 189 Ga. 328, 335, 6 S.E.2d 290, 293 (1939).

86. 601 F.2d 851 (5th Cir. 1979).

87. *Id.* at 855.

88. *Id.* The only deficiency in *Calvert* was for attorney's fees because the mortgagee had purchased the premises for the full amount of his lien exclusive of said fees. However, the court indicated that per its reasoning, the failure to seek timely confirmation and approval of the sale would not extinguish mortgagee's right to recover on any deficiency. *Id.* at 856.

89. *See* note 21 *supra* and accompanying text.

90. *E.g.*, N.Y. REAL PROP. ACTS. § 1371 (McKinney 1979).

area.[91] These jurisdictions consistently hold that to allow a mortgagee who purchases the mortgaged premises to recover insurance proceeds thereon would result in a double recovery. Under this rule, the insurer will presumably not avoid his contractual obligation because the mortgagor, if not party to the instant action, can sue the insurer at a later date.[92]

The New York courts'[93] apparent preference for deficiency judgments as a method of fully satisfying the mortgagee's judgment of foreclosure ignores the formidable obstacles which deficiency judgment statutes place in the mortgagee's path. Commentators[94] and practicing attorneys[95] note that, at least in New York, courts are reluctant to grant deficiency judgments. This is undoubtedly a result of the statute's[96] attempt to mitigate the hardship which results to a mortgagor from a forced sale.[97] The statute guards against the mortgagee's bidding at sale a figure much lower than the fair market value of the premises ("chilling the bid"). The purchaser's bid, under the New York statute, becomes only one of two determinants of the extent of the deficiency. The deficiency is determined by deducting from the foreclosure judgment the higher of the sale price or the fair market value as determined by the court.[98] It has been held that the New York statute is designed to establish a new "equitable standard" in place of market value.[99] Hence,

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91. *See* notes 128-33 *infra* and accompanying text.

92. The mortgagor may sue provided the policy has not lapsed as to him.

93. *See* Whitestone Sav. & Loan Ass'n v. Allstate Ins. Co., 28 N.Y.2d 332, 270 N.E.2d 694, 321 N.Y.S.2d 862 (1971); Grady v. Utica Mut. Ins. Co., 69 A.D.2d 668, 419 N.Y.S.2d 565 (2d Dep't 1979); Moke Realty Corp. v. Whitestone Sav. & Loan Ass'n, 82 Misc. 2d 396, 370 N.Y.S.2d 377 (Sup. Ct. 1975), *aff'd*, 51 A.D.2d 1005, 382 N.Y.S.2d 289 (2d Dep't 1976), *aff'd*, 41 N.Y.2d 954, 363 N.E.2d 587, 394 N.Y.S.2d 881 (1977).

94. Case Note, 35 COLUM. L. REV. 1314 (1935); Case Note, 23 U. VA. L. REV. 718 (1937); interview with the Honorable Robert T. Groh, New York, N.Y. (February 29, 1980).

95. *See* note 68 *supra*.

96. N.Y. REAL PROP. ACTS. § 1371 (McKinney 1979). The statute has been cited as an example of "anti-deficiency legislation" which grew out of the great depression of the 1930's. G. OSBORNE, G. NELSON & D. WHITMAN, REAL ESTATE FINANCE LAW 528 (1979) [hereinafter cited as OSBORNE]. Other examples of such legislation include: CAL. CIV. PROC. CODE § 726 (West 1955); IDAHO CODE § 6-108 (1979); N.C. GEN. STAT. § 45-21-36 (1976); N.D. CENT. CODE §§ 32-19-04, -06, -07 (1976); OKLA. STAT. ANN. tit. 12, § 686 (West 1960); PA. STAT. ANN. tit. 12, § 2621.1 (Purdon 1967); S.C. CODE §§ 29-3-660 — 29-3-760 (1976); S.D. CODIFIED LAWS ANN. §§ 21-47-16, 21-48-15, 21-49-27 (1979); UTAH CODE ANN. §§ 53, 57-1-32 (1953); WASH. REV. CODE ANN. § 61.12.060 (1961).

97. OSBORNE, *supra* note 96, at 528.

98. N.Y. REAL PROP. ACTS. § 1371(2) (McKinney 1979).

99. Heiman v. Bishop, 272 N.Y. 83, 86, 4 N.E.2d 944, 945 (1936).

the courts have considerable discretion in determining market value. In an effort to protect the mortgagor's interests, the "fair market value"[100] is often established by the court at an inflated figure.[101]

The inequity borne by mortgagees under the deficiency judgment statutes is most evident in cases where there is a small difference between the market value of the premises and the mortgagee's lien. As a practical matter, the mortgagee will be dissuaded from pursuing a deficiency judgment where the amount of potential recovery is less than the expense of litigation.[102] Consequently, the mortgagee must choose between either chilling his bid and risking non-collection[103] of the deficiency, or buying the property for the full amount of his lien and risking loss on resale.

C. Where Loss Follows Foreclosure Judgment but Precedes Foreclosure Sale

In *Grady v. Utica Mutual Insurance Co.*,[104] the mortgagee's assignee[105] commenced foreclosure proceedings upon the mortgagor's default and obtained a judgment of foreclosure in the amount of $34,769.46.[106] This figure included taxes and sewer rent paid by mortgagee in addition to the unpaid mortgage debt, interest thereon and costs and expenses of the foreclosure proceeding.[107]

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100. N.Y. REAL PROP. ACTS. § 1371(2) (McKinney 1979).

101. Evidence of the fact that market value of the damaged premises can be inflated is that "value" has been said to approximate tax assessments. G. OSBORNE, MORTGAGES 708 (2d ed. 1970). This figure will usually be higher than post-loss value. Absent anti-deficiency legislation, courts will not refuse to confirm a sale "on account of mere inadequacy of price unless the inadequacy be so gross as to shock the conscience or raise a presumption of fraud or unfairness." OSBORNE, *supra* note 96, at 496.

102. Non-compliance with statutory mechanics might invalidate an otherwise proper claim. *E.g.*, Moke Realty Corp. v. Whitestone Sav. & Loan Ass'n, 82 Misc. 2d 396, 370 N.Y.S.2d 377 (Sup. Ct. 1975), *aff'd*, 51 A.D.2d 1005, 382 N.Y.S.2d 289 (2d Dep't 1976), *aff'd*, 41 N.Y.2d 954, 363 N.E.2d 587, 394 N.Y.S.2d 881 (1977).

103. Obtaining the judgment is not the mortgagee's only difficulty; he must satisfy the same, which may prove impossible if asserted against an insolvent mortgagor.

104. 69 A.D.2d 668, 419 N.Y.S.2d 565 (2d Dep't 1979).

105. Plaintiff Grady was the trustee of the bond and mortgage, which had been assigned to him by mortgagee Louis A. Droesch. *Id.* at 670-71, 419 N.Y.S.2d at 567.

106. 69 A.D.2d at 672, 419 N.Y.S.2d at 568. Added to this figure is interest from the date of judgment. *Id.* For a definition of judgment of foreclosure *see* note 48 *supra* and accompanying text.

107. *Id.* at 671 n.1, 419 N.Y.S.2d at 568 n.1. The appellate division denied plaintiff's claim for $34,969.46 (which included the referee's statutory fee of $200.00 for conducting the sale) on the grounds that the sale was never held and that in any event, since mortgagee was

Before the foreclosure sale could be held, the property was damaged by fire.[108] The mortgagee discontinued his foreclosure action and commenced an action against the insurer for recovery under the fire policy.[109] Defendant/insurer offered to settle with the plaintiff for $22,657.18, which represented the amount of the outstanding mortgage balance plus interest from the date of last payment until loss.[110] Plaintiff declined, maintaining that the mortgagee's insurable interest is measured by the amount of his lien as evidenced by the judgment of foreclosure. The Appellate Division of the New York Supreme Court ruled in favor of the mortgagee and held that the mortgagee's insurable interest was equal to the judgment of foreclosure.[111] The court interpreted the phrase "as interest may appear" to mean that the insurer "undertook to pay plaintiff 'to the extent of his lien or charge upon the premises' as it existed on the date of the fire."[112]

A lesson to be learned from *Grady* is that a mortgagee "fortunate" enough to have his premises destroyed after he obtains a judgment of foreclosure may avoid the inconvenience of holding a sale[113] and thereby guarantee full recovery of his judgment. Considering the mortgagee's recognized right to elect his avenue of recovery[114] and the risks involved in seeking satisfaction of a deficiency judgment,[115] the easiest and safest way for a mortgagee to make himself whole is to demand indemnification from the insurer before a foreclosure sale. Therefore, the distinction between *Grady* and *Whitestone* arguably penalizes mortgagees who have diligently ex-

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not entitled to it, the fee was not part of his lien. *Id.* at 678, 419 N.Y.S.2d at 572.

108. *Id.* at 673, 419 N.Y.S.2d at 568.

109. Although the court supervises a foreclosure action, the mortgagee retains considerable control over it. Before a sale can be held, the mortgagee must give notice. *See* note 47 *supra.*

110. 69 A.D.2d at 672, 419 N.Y.S.2d at 568.

111. The extent of the loss was disputed. Plaintiff claimed the loss was total; defendant claimed that the loss was $33,600.00. The case was remanded to determine the loss upon which the insurer would be liable, *id.* at 678, 419 N.Y.S.2d at 572, and later settled. *See* note 68 *supra.*

112. 69 A.D.2d at 674, 419 N.Y.S.2d at 569-70 (citations omitted).

113. Naturally, this presumes that loss and policy coverage exceeded the judgment of foreclosure.

114. *See* note 72 *supra* and accompanying text.

115. *See* notes 94-103 *supra* and accompanying text. *See also* Moke Realty Corp. v. Whitestone Sav. & Loan Ass'n, 82 Misc. 2d 396, 370 N.Y.S.2d 377 (Sup. Ct. 1975), *aff'd*, 51 A.D.2d 1005, 382 N.Y.S.2d 289 (2d Dep't 1976), *aff'd*, 41 N.Y.2d 954, 363 N.E.2d 587, 394 N.Y.S.2d 881 (1977).

ercised the legal right of foreclosure.

In *Morgan v. Ellenville Savings Bank*,[116] the mortgagor defaulted on his obligation and the mortgagee commenced foreclosure proceedings. Prior to the entry of a judgment of foreclosure, the building on the premises was destroyed by fire. A judgment of foreclosure was entered and the referee included in the terms of sale a statement that if the mortgagee did not bid in the full amount of his debt[117] at sale, the referee would assign to the purchaser such proceeds of insurance as might be payable by reason of the fire loss.[118] At sale, the mortgagee was the sole bidder and purchased the property for the exact amount of his judgment. The mortgagee argued that, because it was the purchaser, it should receive the benefit of the referee's assignment clause, namely, the insurance proceeds.[119] The appellate division denied recovery and held that because the mortgagee bid in the exact amount of its foreclosure judgment at sale, under *Whitestone* it extinguished its recovery rights, despite the fact that it suffered an actual loss of $11,000.[120] The court noted that the referee was powerless to change the terms of sale fixed by the judgment of foreclosure and thereby direct the flow of insurance proceeds.[121] Had the mortgagee not relied on the referee's directions and simply refrained from bidding in at sale, under the *Grady* rationale it would have avoided its $11,000 loss.

D. Where Loss Precedes Foreclosure Judgment

The New York courts have yet to be confronted with a case where loss follows an act of default but precedes a judgment of foreclosure and where, because of *Grady*, a sale will not be held.[122] *Grady* held that, on its facts, the mortgagee's interest is equal to the lien or charge upon the premises as it existed on the date of the

116. 55 A.D.2d 178, 389 N.Y.S.2d 660 (3d Dep't 1976).

117. The referee required that the mortgagee "bid in the property," meaning that the purchase of the mortgaged property was for the full amount of the debt. *Id.*

118. It is unclear why the referee succeeded in forcing the mortgagee to bid at sale. Had a purchaser made a higher bid than the mortgagee, the sale proceeds would have first been used to satisfy the judgment of foreclosure. *See* note 52 *supra* and accompanying text.

119. 55 A.D.2d at 179-80, 389 N.Y.S.2d at 660.

120. *Id.* at 180, 389 N.Y.S.2d at 661.

121. *Id.*

122. A mortgagee cognizant of the loss/foreclosure rules discussed above may not proceed with a foreclosure sale. *Compare* Grady v. Utica Mutual Ins. Co., 69 A.D.2d 668, 419 N.Y.S.2d 565 (2d Dep't 1979) *with* Whitestone Sav. & Loan Ass'n v. Allstate Ins. Co., 28 N.Y.2d 332, 270 N.E.2d 694, 321 N.Y.S.2d 862 (1971).

fire.[123] It is unclear whether this means that the mortgagee's "interest as it appears" is frozen at the moment his security is damaged or destroyed or whether disbursements made by the mortgagee subsequent to the damage are included in the insurable interest. *Grady* did not reach this issue because the loss occurred subsequent to the entry of the judgment of foreclosure.

If *Grady* is construed to hold that only debts recognized by judgment at the moment of fire may compose the mortgagee's lien, inequities will clearly result. Foreclosure expenditures, such as attorney's fees and payment of taxes during the pendency of the action, can and must be made prior to judgment. Such a construction of *Grady*, however, is not consistent with the decision in *Whitestone*. In *Whitestone*, the judgment of foreclosure included post-loss expenses. Because the *Whitestone* court equated the mortgagee's unsatisfied judgment[124] with his insurable interest, it effectively held that the insurer is liable for post-loss expenses.

IV. Rationale for the Loss/Foreclosure Rules

The decisions denying a standard clause mortgagee recovery in situations where loss precedes purchase at foreclosure have been criticized.[125] It is asserted that a contract of insurance should be construed to give full effect to the expressed intention of the parties.[126] Moreover, insurance contracts are generally interpreted strictly against the insurer and in favor of the insured and beneficiary.[127]

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123. 69 A.D.2d at 674, 419 N.Y.S.2d at 569. *See also* National Fire Ins. Co. v. Finerty Inv. Co., 170 Okla. 44, 46, 38 P.2d 496, 498 (1934).

124. The judgment includes post-loss expenses and disbursements made by the mortgagee. *See* note 48 *supra* and accompanying text.

125. *See, e.g., Observations, supra* note 39.

126. VANCE, *supra* note 9, at 808.

127. *Id.* at 809. This is consistent with the general rule that ambiguity in a contract should be resolved to disfavor the drafter. *Id.*

States are sharply divided, however, on whether the usual rules for the construction of insurance contracts should be applied to standard policies and to standard provisions. *Id.* A bare majority of jurisdictions feel that since terms and conditions of the standard policy are mandated by law, the insurance carrier cannot be regarded as having selected the operative language and therefore should not be subjected to an unfavorable rule of construction. Guardian Life Ins. Co. v. Barry, 213 Ind. 56, 10 N.E.2d 614 (1937); St. Landry Wholesale Mercantile Co. v. New Hampshire Fire Ins. Co., 114 La. 146, 38 So. 87 (1905); Mac Bey v. Hartford Acc. & Ind. Co., 292 Mass. 105, 197 N.E. 516 (1935); Wilcox v. Massachusetts Protective Ass'n, 266 Mass. 230, 165 N.E. 429 (1929); Bay Trust Co. v. Agricultural Life Ins. Co., 279 Mich. 248, 271 N.W. 749 (1937); Del Guidici v. Importers & Exporters Ins. Co., 98

It has been argued that what the mortgagee does subsequent to loss in foreclosing on its lien is irrelevant to the insurer's contractual duty to pay.[128] A policy of fire insurance is generally viewed as a personal contract, which "does not attach to the property insured nor in any manner run with the land."[129] Where the policy contains a clause directing that recovery for any loss be payable to a named mortgagee, it "is not a separate insurance of the debt, but is a separate security for the debt."[130] Therefore, the mortgagee should be able to look to the security provided by the policy to make it whole and entire.[131]

The courts in New York recognize the general rule that the standard mortgage clause operates to create a separate contract of insurance between the mortgagee and insurer[132] but the effect of *Whitestone* and *Moke* is to deny that a separate contract exists. Unlike the decision in *Calvert,* the New York cases apply real property law, governing the relationship between mortgagor and mortgagee, to an essentially contractual relationship between mortgagee and insurer.[133] By such application, the real property law can work

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N.J.L. 435, 120 A. 5 (1923); Solomon v. United States Fire Ins. Co., 43 R.I. 154, 165 A. 214 (1933); Frozine v. St. Paul Fire & Marine Ins. Co., 195 Wis. 494, 218 N.W. 845 (1928). Other courts have seen these policies "not as legislative enactments but as voluntary contracts" and give the benefit of any doubt to the insured. Dunton v. Westchester Fire Ins. Co., 104 Me. 372, 71 A. 1037 (1908); Matthews v. American Central Ins. Co., 154 N.Y. 449, 48 N.E. 751 (1897); Blue Bird Cab Co. v. American Fidelity & Cas. Co., 219 N.C. 788, 15 S.E.2d 295 (1941); Chauvin v. Superior Fire Ins. Co., 283 Pa. 397, 129 A. 326 (1925); Straw v. Integrity Mut. Ins. Co., 248 Wis. 96, 20 N.W.2d 707 (1945); Ruffino v. Queen Ins. Co. v. O'Bannon, 170 S.W. 1055 (Tex. Civ. App. 1941), *aff'd*, 109 Tex. 281, 206 S.W. 814 (1918). Such courts cite the influence the insurance industry exerts in the drafting state of standard fire policy legislation. VANCE, *supra* note 9, at 810.

128. *E.g.*, Brief for Appellant, Nationwide Mut. Fire Ins. Co. v. Wilborn, 291 Ala. 193, 279 So. 2d 460 (1973); Brief for Appellant, Whitestone Sav. & Loan Ass'n v. Allstate Ins. Co., 28 N.Y.2d 332, 270 N.E.2d 694, 321 N.Y.S.2d 862 (1971).

129. Galante v. Hathaway Bakeries, Inc., 6 A.D.2d 142, 149, 176 N.Y.S.2d 87, 94 (3d Dep't 1958).

130. Andrello v. Nationwide Mut. Fire Ins. Co., 29 A.D.2d 489, 493, 289 N.Y.S.2d 293, 297 (4th Dep't 1968) (quoting Fields v. Western Millers Mut. Fire Ins. Co., 290 N.Y. 209, 214, 48 N.E.2d 489, 491 (1943)).

131. Brief for Appellant at 9, Whitestone Sav. & Loan Ass'n v. Allstate Ins. Co., 28 N.Y.2d 332, 270 N.E.2d 694, 321 N.Y.S.2d 862 (1971).

132. *See* Whitestone Sav. & Loan Ass'n v. Allstate Ins. Co., 28 N.Y.2d 332, 270 N.E.2d 694, 321 N.Y.S.2d 862 (1971); Grady v. Utica Mut. Ins. Co., 69 A.D.2d 668, 419 N.Y.S.2d 565 (2d Dep't 1979); Moke Realty Corp. v. Whitestone Sav. & Loan Ass'n, 82 Misc. 2d 396, 370 N.Y.S.2d 377 (Sup. Ct. 1975), *aff'd*, 51 A.D.2d 1005, 382 N.Y.S.2d 289 (2d Dep't 1976), *aff'd*, 41 N.Y.2d 954, 363 N.E.2d 365, 394 N.Y.S.2d 881 (1977).

133. *See* note 132 *supra*.

to defeat an otherwise valid, executory contract. This occurs when the mechanics of the deficiency judgment statute extinguish recovery rights arising under the insurance contract.

The *Moke* decision is apparently premised upon two bases: 1) a desire to avoid delay in the prosecution of the foreclosure action and 2) a desire to clear title to the mortgaged premises as quickly as possible. Both of these goals, however, can be realized without using the deficiency judgment statute as a catalyst. First, the statute of limitations on the contract action or an analogous time limit in the policy under which claims must be filed will guard against undue delay in bringing claims against the insurer. Second, the mortgagee who has bid in the property and become owner is likely to resell the same as soon as he can. Therefore, there is little likelihood that a cloud will remain on title for any significant length of time.

It is also argued that to allow a mortgagee who has had his debt fully satisfied at foreclosure to collect on insurance proceeds would amount to a double recovery.[134] This argument presumes that the actual market value of the premises which the mortgagee purchases at foreclosure sale is always equal to the amount of his bid. However, this fiction ignores the fact that, because of anti-deficiency legislation, the mortgagee is frequently compelled to offer a bid greater than the amount for which he can later resell the premises.[135] In a case like *Whitestone*, the mortgagee would not obtain a double recovery by receiving insurance proceeds in addition to its fee interest. Rather, the insurer is unjustly enriched if it is not liable to the mortgagor or some third person.[136]

Furthermore, it is illogical to characterize as double recovery the excess of the resale price over the mortgagee's purchase price. Such excess is more properly considered a capital gain on the sale of real property. There is no danger that a mortgagee can successfully make a bid for less than fair market value in order to increase his profit and receive insurance proceeds on the deficiency because, under anti-deficiency legislation, a court will grant a deficiency judgment based upon the perceived fair market value of the premises. Theoretically, the mortgagee will receive no benefit from the

134. Whitestone Sav. & Loan Ass'n v. Allstate Ins. Co., 28 N.Y.2d 332, 270 N.E.2d 694, 321 N.Y.S.2d 862 (1971).

135. *See* note 103 *supra* and accompanying text.

136. 28 N.Y.2d at 343, 270 N.E.2d at 700, 321 N.Y.S.2d at 870 (Scileppi, J., dissenting).

"forced nature" of the foreclosure sale.[137]

The most cogent justification for the *Whitestone* rule is the presumption that the mortgagee is in a better position than the insurance company to know the condition of premises forming the security for his lien. The mortgagee is under no duty to commence foreclosure proceedings and could have recovered from the insurer instead of his debtor.[138] Therefore, if the remedy chosen is foreclosure, the mortgagee should not be later heard to complain that his choice was unwise.

V. Conclusion

The rules governing fire insurance recovery rights of the foreclosing mortgagee may appear to be a viable solution to apportionment of indemnity. However, when the rules are applied to deny recovery to mortgagees properly insured against the loss sustained, the system of justice has failed.

It is clear that a mortgagee's insurable interest is reduced to the extent that his lien upon the premises has been satisfied. This principle is a sound one. What is perhaps illogical is the fiction that the mortgagee's bid at foreclosure sale equals the value of the premises he is receiving in exchange. Such equality often does not exist because the practical difficulty in obtaining a deficiency judgment encourages some mortgagees to bid in the amount of their liens even where the premises are worth less than such liens. Hence, the mortgagee who holds a foreclosure sale may never fully recover his investment: if his bid is low, the law effectively may deny him recovery by reducing his deficiency judgment; if he bids an amount greater than the premises are worth, the market may refuse to pay on resale what the mortgagee paid at auction.

The judicious mortgagee who has had his security interest damaged or destroyed and has a right to recover insurance proceeeds thereon would be well advised simply to refrain from foreclosing, file a claim, and let the carrier be subrogated to his lien. But should the mortgagee have commenced foreclosure and hold an unsatisfied judgment on the date of the fire, he should surely avoid the sale.

J. Burke McCormick

137. *See* notes 97-100 *supra* and accompanying text.

138. *See* note 71 *supra* and accompanying text.